Summary

The following contents of this document are regarding the All-State Survey sent out by the NAIC on behalf of Arkansas concerning the depreciation of labor under an actual cash value (ACV), and the details thereof. The states were given two full weeks to respond, and were sent a reminder closer to the deadline.

We have received responses from 24 jurisdictions as of Friday, September 26, 2008. The data was compiled into detailed, verbatim responses from the states.

In one instance, a state provided some additional information. Wisconsin has provided such information for more elaboration on this topic.

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EXHIBIT
C

Labor Depreciation under ACV – State Survey
(Detailed Results)

Questions

1. Does your state allow the depreciation of labor under an actual cash value (ACV) loss settlement provision for property?

California: No. See 10 CCR 2695.9(f)(1).

Colorado: The Colorado Division of Insurance has taken the position that depreciation of labor (or overhead & profit) is not allowed when settling a claim for ACV.

Georgia: Policies in Georgia are not explicit on this issue, but depreciation in both materials and labor are implied due to the most common definition of "ACV which is Replacement Cost less Depreciation.

Kentucky: Yes.

Maine: Yes.

Mississippi: Yes.

Missouri: Missouri law is silent on the specific issue of depreciation of labor. Besides the lack of statutory guidance, there have been no court decisions in Missouri as to this specific issue.

The Missouri DIFP's position has historically been that depreciation of labor should be analyzed on a case by case basis. Where there is betterment to the insured, or where labor is the primary component of the cost of repair, depreciation of labor may be an appropriate consideration in claims settlement.

Montana: ACV generally does not include labor. A repair job is approximated, bid, and settlement is generally what the contractor bids. If there is no coins or other cost considerations, payments can be made right there. Shortages are up to the property owner & the only thing set in cement is a total loss.

Nebraska: Nebraska case law is dependent upon an analysis of the policy provisions. The Department has not taken a position on this issue, but is aware that the issue was addressed by FC&S to indicate there may be circumstances where depreciation of labor should be considered.

New Hampshire: No.

North Carolina: This is not addressed in North Carolina laws or in the policy provisions of residential policy programs approved for use in this State.

North Dakota: Yes. North Dakota views ACV as applying depreciation to the Replacement Cost Value (including labor).

Oklahoma: Yes.

1. Does your state allow the depreciation of labor under an actual cash value (ACV) loss settlement provision for property? (cont'd)

Oregon: Oregon has not made a formal policy statement regarding the depreciation of labor, as, to our knowledge this has not been an issue.

Oregon Revised Statute(ORS) 742.706 is based on the standard fire policy wording which states: ..[to the extent of the actual cash value of the property at the time of loss, but not exceeding the amount which it would cost to repair or replace the property with material of like kind and quality within a reasonable time after such loss, without allowance for any increased cost of repair or reconstruction by reason of any ordinance or law regulating construction or repair, and without compensation for loss resulting from interruption of business or manufacture,]

Oregon statute does not define "Actual Cash Value". We would look to the policy contract for the definition in the event of a consumer concern. After reviewing this internally, we do not believe that labor should be subject to depreciation. ISO wording refers to "the amount it would cost to repair, rebuild or replace the property less a fair and reasonable deduction for physical depreciation". Webster's defines depreciation as "a decrease in value of property through wear, deterioration or obsolescence. Labor is not subject to physical depreciation.

Pennsylvania: Yes.

Rhode Island: lease note that Insurance Regulation 73, Section 8 provides as follows:

Section 8: Standards for Prompt, Fair and Equitable Settlements Applicable to Fire and Extended Coverage Type Policies with Replacement Cost Coverage A. Replacement Cost When the Policy provides for the adjustment and settlement of First Party Claimant losses based on replacement cost, the following shall apply:

(1) When a loss requires repair or replacement of an item or part, any consequential physical damage incurred in making such repair or replacement not otherwise excluded by the Policy, shall be included in the loss. The Insured shall not have to pay for betterment nor any other cost except for the applicable deductible.

(2) When a loss requires replacement of items and the replaced items do not match in quality, color or size, the Insurer shall replace all such items so as to conform to a reasonably uniform appearance. This applies to interior and exterior losses. The Insured shall not bear any cost over the applicable deductible, if any.

B. Actual Cash Value

(1) When the Policy provides for the adjustment and settlement of losses on an actual cash value basis on residential fire and extended coverage, the Insurer shall determine actual cash value as follows:

replacement cost of property at time of loss less depreciation, if any.

Upon the Insured's request, the Insurer shall provide a copy of the Claim File worksheet(s) detailing any and all deductions for depreciation.

(2) In cases in which the Insured's interest is limited because the property has nominal or no economic value, or a value disproportionate to replacement cost less depreciation, the determination of actual cash value as set forth above is not required. In such cases, the Insurer shall provide, upon the Insured's request, a written explanation of the basis for limiting the amount of recovery along the amount payable under the policy.

1. Does your state allow the depreciation of labor under an actual cash value (ACV) loss settlement provision for property? (cont'd)

South Dakota: By default, yes as there is no provision in South Dakota law that addresses this issue.

Tennessee: It is generally the belief that labor is not depreciable, but the Department has no written position on the matter. We believe there is some case law supporting this aspect. To our knowledge, this is not a problem here.

Texas: Yes. However, subject to specific policy language debris removal under extensions of coverage may or may not depreciate labor.

Utah: Depreciation on Labor is not addressed in the Utah Insurance Code. We have not received any complaints on this issue nor have we had inquiries from Insurers concerning the practice of depreciation of labor.

Virginia: There is no specific insurance statute or regulation that addresses this issue in Virginia. However, since the basic fire policy pays the cost to repair or replace the property with materials of like kind and quality or the actual cash value at the time of loss, it would be unusual for a company to depreciate labor.

Washington: If the definition of actual cash value is specific enough to allow it. There is one insurer that has added depreciation language to a property policy, but we can't remember which one. There are no statutes, administrative rules or case law in Washington that prohibit depreciation of labor in an ACV loss settlement provision.

Wisconsin: Yes.

Wyoming: Depreciation of labor is not allowed on ACV claims. The position of the Wyoming Insurance Department is that labor is not tangible.

2. If so, is there a formula or specified percentage? Please provide any related statutes.

California: Not applicable.

Colorado: N/A

Georgia: There is not a specific formula specified in either statute or regulation.

Kentucky: No. The depreciation is taken from the entire amount. Labor is not singled out as a depreciated item.

Maine: No.

Mississippi: No statues – depends on the individual companies.

Missouri: No, none. Missouri law is silent on the specific issue of depreciation of labor. In addition to a lack of statutory guidance, there have been no court decisions in Missouri as to this specific issue.

Montana: No % ages.

Nebraska: N/A

New Hampshire: N/A

North Carolina: N/A

North Dakota: No - no related statutes.

Oklahoma: Supreme Court of Oklahoma Case No. 96562 – March 12, 2002, Filed. Charles Redcorn, Plaintiff, v. State Farm Fire & Casualty Company, and State Farm General Insurance Company, Defendants.

Oregon: N/A

Pennsylvania: No, there is no special or specified percentage. There are no statutory prohibitions against using such a technique.

Rhode Island: Please see #1.

South Dakota: No.

Tennessee: N/A

Texas: Does not apply.

Utah: N/A

Virginia: Not applicable.

Washington: No.

Wisconsin: *See additional information.* We don't have a formula or specified percentage nor a statute or rule. We allow depreciation of labor based on industry practice. Please see the attached excerpt from the study book, AIC 35 Property Loss Adjusting Volume I, regarding depreciating labor.

Wyoming: N/A

3. **Is depreciation for labor allowed on ACV roof if it is totally replaced?**

California: No. See 10 CCR 2695.9(f)(1).

Colorado: No.

Georgia: Yes.

Kentucky: Yes.

Maine: Yes.

Mississippi: Yes.

Missouri: The Missouri DIFP has not taken a formal position regarding depreciation of labor. See answers to #1 and #2 above.

Montana: ACV on a roof is much like # 1, Montana has ACV& Rep cost cover with flat ded's and % ded's. Nothing is mandated in code.

Nebraska: N/A

New Hampshire: No.

North Carolina: See response to #1

North Dakota: N/A

Oklahoma: See case.

Oregon: N/A

Pennsylvania: Yes.

Rhode Island: Please see #1.

South Dakota: Yes.

Tennessee: We do not believe insurers are depreciating labor unless their policy provision calls for it. At least one insurer has a policy provision addressing this issue.

Texas: Yes – subject to specific policy language.

Utah: N/A

Virginia: Again, no specific statute. Typically the entire cost of the replacement of the roof would be established and depreciation calculated on the overall cost to replace the roof. From a regulatory standpoint, we require companies to have a supportable reason for their position.

Washington: Most property policies are written on a replacement cost basis if repairs are done. We have not had any consumer complaints where an insurer is depreciating materials or labor when an insured actually repairs the home.

Wisconsin: Yes.

Wyoming: N/A

4. **Is depreciation for labor handled any differently if the roof is repaired?**

California: Not applicable.
Colorado: No.
Georgia: No.
Kentucky: Yes.
Maine: Probably.
Mississippi: No.
Missouri: The Missouri DIFP has not taken a formal position regarding depreciation of labor. See answers to #1 and #2 above.
Montana: Roofs might be ACV until repaired and then rep costed the difference when repairs-replacement is made-done. The companies are pretty consistent in the common treatments of roof repair or replacement.
Nebraska: N/A
New Hampshire: No.
North Carolina: See response to #1
North Dakota: N/A
Oklahoma: See case.
Oregon: N/A
Pennsylvania: No.
Rhode Island: Please see #1.
South Dakota: Yes.
Tennessee: See previous responses.
Texas: No.
Utah: N/A
Virginia: Your point about labor not depreciating is well taken. Typically, companies would not depreciate straight labor costs. Again, there is no specific Virginia statute but we would expect the company to support its position on a case by case basis if it did elect to depreciate labor on a specific repair.
Washington: If repairs are not done, the actual cash value provisions of policies can be triggered. Most policies in Washington say ACV is fair market value, but alternative definitions can be used if they are clear and unambiguous.
Wisconsin: No.
Wyoming: N/A

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Additional Information

(Wisconsin)

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Depreciation Fallacies

When depreciation does apply in the valuation of a loss, it must be carefully evaluated and calculated. In making the calculation, the adjuster must use sound judgment and avoid common fallacies about depreciation.

Maximum Amounts. Some adjusters believe that personal property never depreciates more than 50 percent. There is no basis in fact for such a generalization. It may be true for some items, especially those with a nearly indefinite lifespan, but most types of personal property can and will lose value to the point of worthlessness.

Material Only. Some adjusters believe only the material and not the labor should be depreciated. This makes little sense. An object derives value from both the material and labor that went into it. For example, assume that a twenty-year-old living room couch has served its useful life and is to be disposed of. More than just the material has depreciated: if material costs $150, and the labor to manufacture the piece (including profit) costs $200, the couch was worth $350. Now, twenty years later, all of its value has been "used up," not just the value represented by the material. The entire couch is worthless.

Book Depreciation. The book depreciation of an item for tax purposes should not be used by the adjuster as a controlling factor in an insurance claim. Businesses will depreciate property as fast as possible for tax purposes, but property does not actually depreciate at this rate. While book depreciation and actual depreciation may happen to coincide, an adjuster should not expect this to be the case.

Depreciation

Actual cash value must be determined differently for different types of property. The following discussion highlights how different types of property may be depreciated as well as some factors that affect the changes in value of a given item of property.

Straight Line Depreciation. In most jurisdictions and in most circumstances, personal property is depreciated using the straight line method, in which a fixed percentage or fraction is deducted from the replacement cost every year. Buildings too are typically depreciated using the straight line method and might be subject to a 1 percent depreciation per year. However, there is nothing really scientific about this approach. The longevity of a building, like an item of personal property, depends on a number of factors. It is not uncommon for a building to be utilized well after 100 years (1 percent a year